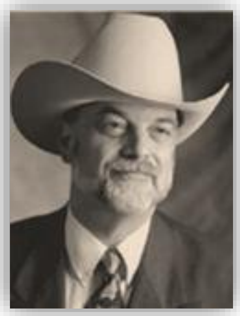

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX) ended the week at 2,348.69, up 0.85% from last week, but still down about 1.5% from where it was in early March of this year. It remains up over 16% from this time last year and 4.91% year-to-date. The good news was that it didn't continue the gradually accelerating decline that has been growing for the past several weeks. Gold dropped about 0.4% to $1,286.40 per troy ounce and the 10-year U.S. Treasury showed a slight increase in yield to 2.24%. Gold and the Treasury index both are still down about 6% from last summer.

To throw in some additional numbers to which we can better relate, the average money market annual yield is still tiny at 0.32%. Five year FDIC insured CDs averaged 1.31%, while 30 year fixed mortgages were at 3.98%, and new car loans 3.11%.

The bottom line is that not much changed in the vital statistics we call "the markets." Still there is an anomaly here. If we conclude that markets tend to reflect an underlying reality in the economy, we must turn to the bigger picture to see it and try to understand what is happening.

The Economy

Reality continued to trump (pun intended) hype this week as the decline in both consumer spending and prices triggered more consideration of what is possible, likely, and increasingly unlikely.

Following the elections in November there appears to have been a consensus among investors and business leaders that with Republicans, a traditionally pro-business party, controlling both houses of Congress and the White House, some critical changes would quickly come to pass. The key elements that investors and business leaders wanted to see were a tax reduction for corporations and strong infrastructure spending. No matter how one looks at those two items, they translate into bigger profits for corporations and a faster growing economy.

Both individual and business optimism surveyed earlier this year were the highest since the end of the 20th century, back in the go-go days of the '90s. For a short time both business and consumer spending surged in late 2016, then cold reality began to set in. What people say they are feeling may be important, but seeing what they are doing is more important. When consumers are spending more money buying things, prices move upward. When they pull back and buy less, prices fall. Last month, consumer prices fell 0.1%. That corresponds well with the Census Bureau's reports that as wages have risen over the past year, savings rates have gone up, and much of the new income is not being spent.

There is a lot to be said for an increased saving rate, but as the Japanese have demonstrated, if consumers save too much, the economy does not grow much, if at all, and interest rates stay low. The Commerce Department's Bureau of Economic Analysis ("BEA") reported that consumer disposable income rose 0.3% in February, but spending was only up 0.1%. Our personal saving rate here in the United States has risen to 5.6%.

Here is the conundrum. One would think that with interest rates as low as they are (see *Markets* above) that a rational person would choose to spend the money rather than save, but that is not how reality works. Oddly, if we had higher inflation and, as a direct result, higher short term interest rates, people would be more likely to spend. If they were to do that, it would tend to make the economy grow faster, and more wealth would be created.

There is a circular cause and effect that then is triggered. Before the "Great Recession" of 2008-2009, the 10-year US Treasury rate averaged around 4.25% while inflation averaged around 3% according to the Federal Reserve Bank of St. Louis. Today, the same maturity Treasury note averages around 2.25% and seems to get knocked back to that range every time rates go up even a little. Meanwhile, core inflation is the highest it has been in years at a weak 1.8%.

With five-year CDs at 1.31% one would suppose that people would not be doing much saving, but ironically, the very reason that interest rates are so low, including on CDs, is that there is simply more saving demand than borrowing demand. That economic reality had a confirmation this week as there was high demand for a $16 billion 5-year Treasury Inflation Protected Security ("TIPS") auction. At purchase that $16 billion in bonds had a yield to maturity of -0.049%. Yes, there was a "-" in front of that interest rate. For every dollar the Treasury wanted to borrow, there was $2.52 bid.

There is a fundamental reason behind this high savings rate that has pushed some 5-year Treasuries down to negative returns. That reason is uncertainty accompanied by fear. There is still hope for a miraculous break out in government policy, but as the hope for lower taxes and higher spending fades, investors and business are building up their reserves rather than focusing on expanding. That fear reaction is compounded by the President's often strident tweets and the absence of action following administration proclamations and promises.

The same story we have reported before continues though. Despite the absence of clear leadership from Washington, the U.S. economy keeps chugging along. Corporations continue to squeeze more profit from revenues that are not growing very fast and the rest of us are not drawing back, but we are not surging ahead either. Expect to see a weak GDP number for the first quarter, probably at about 0.5% growth. Corporate profits (earnings) still look to be ahead double digits from last year. There are indications that we will see growth in the GDP pick up later in the year.

By the way, if this all sounds a lot like what we were writing in 2016, it is because it is. Despite all the rhetoric, little has changed and it is looking more and more as though little will change in 2017. Any presidential administration can only create change, even in the executive branch, with a substantial team in place to execute that change. Unfortunately, there are around 500 senior presidential appointments that are unfilled. As of mid-April, the White House had not submitted nominations for the vast majority of those positions, so change, if any, will be slow in coming.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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